SPRINGFIELD POLICE/FIRE PENSION BOARD

2009 YEAR END REPORT TO

SPRINGFIELD CITY COUNCIL

Submitted by: Cynthia Rushefsky

Liaison, Springfield City Council

Voting Members of the Board:

Ken Homan, Springfield Trust Company *Chairman*

Beau Barrett, Kirkpatrick Phillips & Miller

David Carter, Springfield Fire Department

Jim Edwards, Springfield Police Department

Steven Fenner, Esq. Attorney

David Hall, Springfield Fire Department

Ron Hoffman Springfield Fire Department (retired)

Jim McCulloch, Springfield Police Department

Non-Voting Members of the Board:

Mary Mannix Decker, City Finance Director

Cynthia Rushefsky, City Council Liaison

Dan Wichmer, City Attorney

***Evelyn Honea, Deputy City Manager**

***Sheila Maerz, City Human Resources Director**

***Currently not participating**

Staff:

Nikki White, Secretary

FUND MANAGER: **SEGAL ADVISORS, New York**

Gino Reina, CFA

INVESTMENT MANAGERS:

State Street Global Advisors	**All Cap Equity**	**4/30/07 to date**
Pictet Asset Management Ltd	**Internat'l Core**	**2/29/08 to date**
Galliard Capital Mgmt., Inc.	**Fixed Inc. Intermed**	**7/01/08 to date**
Brandywine Global, LLC	**Fixed Inc. Internat'l**	**4/30/07 to date**
Prudential Real Estate Inv.	**Real Estate**	**9/30/07 to date**

SUMMARY

This year has ended considerably brighter than it began last January. Calendar year 2009 started with heavy investment losses, a Fund that had been thrown considerably off its allocation targets by the unprecedented market fluctuations, and warnings of another difficult year. Attempts to deal with the growing unfunded liability with a 1 cent sales tax failed in February and the situation appeared grim. In late Spring, however, the Fund's investment reports began showing positive returns for the first time in many months and cash balances benefitted from an influx of money from legal settlements and other sources. Despite contentious political issues, major staffing changes and the temporary loss of some support personnel, the Board conducted a five year review of Fund assumptions and procedures, met with each of its investment managers, and began the process of reevaluating investment strategies. By the end of the year, the Fund saw significant increases in investment returns and the prospect of a five year revenue stream to help deal with the unfunded liability. In addition, important issues as to the power and accountability of the

Board are being addressed by Council and should greatly facilitate effective communication and understanding between the Board and Springfield citizens.

I. FINANCIAL REVIEW

Calendar year 2008 ended with the Fund at $101,829,000, a loss of $14.7 million over the previous year. Return on investments was -4 ½%, a long drop from the assumed return rate of 7.5%. Further complicating the picture was the unfunded liability of about $200 million. Investment allocations had been significantly skewed by the changes in the market. International fixed income, for example, was targeted to be 10 ¾% of the portfolio, but was 14% in December, 2008. Fixed income was targeted at 21 ¾% but was actually 25%. Real estate at 13% was nearly twice its targeted goal of 7 ½%. Although real estate had been one of the brighter aspects of the portfolio in 2008, concerns about revaluation of Prudential property holdings in a devastating market for real estate and a 12 month queue for withdrawals had led the Board to place $5 million of its real estate allocation money on the waiting list for withdrawal. In addition, the Board had expressed a desire to its Fund Manager to begin looking for an investment vehicle that would help protect the Fund in any future market downswings.

Beginning in January, the Board began a series of meetings with the Fund's investment managers. Bad weather caused some cancellations, but by May, the Board had met with representatives of each investment group. In addition, the Board has met regularly with Gino Reina, the Segal representative and overall fund investment manager. In February, despite the dismal market conditions, Reina still believed that a 7 ½% return over ten years was realistically attainable with the existing allocation policy. Although the Fund had dropped 27% in value from the previous year, Reina indicated that the Fund was functioning on a par with similar pension funds and was not out of step with overall market conditions. The Board discussed the need for a new asset allocation study, but Reina did not recommend it at that point.

By April, 2009, the Fund had dropped in value to $89.4 million. In May, however, the financial picture began to brighten slowly. Both Pictet and State Street Global had seen significant increases and despite a decline of $1.6 million in PRISA investments due to revaluation of property holdings complicated by a dearth of mortgage lending money, the Fund's overall investment assets had increased in value to $91,882,000. Reina indicated that although the revaluations were obviously creating problems for PRISA, the assets in the portfolio were generally stable commercial properties with 91% occupancy rates and relatively strong income streams. By August, PRISA had dropped 40% overall and it was decided to put out a sell order on the remaining funds. Reina indicated that he would be looking for a new real estate fund manager.

By August, 2009, the earlier discrepancies in the asset allocation targets and actual performance had largely reconciled . Bond assets and international fixed assets remained slightly over target and equities were slightly below target. The second quarter saw returns of 11.5%, in line with the benchmark. In September, Reina reported that all of the Fund managers had beaten their indexes for the previous quarter except for PRISA.

Also in September, Michael Zweiner of Milliman Associates, the Fund's actuaries, presented the results of an Experience Study for the five year period from July 1, 2004 to June 30, 2009. The purpose of the study, which is done every five years, is to review the actuarial assumptions and procedures used in the annual funding calculations for the Pension Fund. The recommended contribution rates are generally determined from this study. However, it should be noted that the anticipated closure of the Fund in 2010 means that portions of the study will need to be redone.

Zweiner reported that although the Fund had experienced negative returns for a significant period, they were not out of line with other similar pension funds for the same period. Milliman continued to believe that a 7 ½% rate of return on investments over a 20 year time horizon was realistic. They did recommend some changes to the adjustment factor to average salary at retirement for police and fire for some age groups. Milliman reported that

turnover rates increased for police (77 actual; 67 anticipated) but decreased for fire. Retirement, on the other hand, exclusive of retirements forced by disability, were significantly higher than anticipated within the 45-52 age group (47 anticipated; 67 actual) and required an assumed increase of 5% for that age group.

Another area of change was the assumption of aggregate payroll growth. Milliman recommended a reduction in the assumption from 4% per year to 3%. Milliman also recommended that the Fund move gradually to a reduction in the amortization period of the unfunded liability from 30 years to 20 years in order to match State recommendations. If the Plan closed and the payroll deteriorated as Tier I employees diminished, it did not make sense to keep a 30 year amortization period. Zweiner also recommended that if the Plan closed, the Board move to a level dollar amortization of the unfunded liability rather than a level percentage of payroll which would overburden remaining members.

Milliman recommended continued use of asset smoothing . The method compares the amount of investment income expected under the assumed rate and compares it to the investment income actually experienced. The difference is spread over 4 years. In the state of the market as of June, smoothed asset value was 31% higher than market value. Zweiner reminded the Board that over the next 3 years, an additional $8.8 million of the investment loss experienced by the Fund would be reflected in the actuarial value of assets. For that reason, the market would have to return significantly more than 7 ½% to return the assumed rate on our investments under the smoothing process.

The most significant change recommended by Milliman was a significant increase in the Additional Funding Contribution required to pay for the 3/10 multiplier used to determine retirement benefits. Under City ordinance, this benefit is to be paid totally from employee contributions. Because of the changes made to the Plan by the City in 2006 to close the Plan, the number of employees available to pay for the benefit is declining. The AFC rate in 2004 was 2.85. However, the new rate required to cover the AFC is 7.52%. This is in addition to the base employee contribution rate for Tier I employees of 8.5%. As

Tier II employees move the LAGERS, which does not require an employee contribution, the discrepancy will become more pronounced. Although the Board ratified the change recommended by the actuary, the Board wanted City Council to be aware that if Tier I had not been closed in 2006, the contribution increase necessary to fund this benefit would have been only 4.75% vs. 7.52%.

In October, the Fund was reported at $120,191,130, with investment gains of $2.7 million over the previous month. Milliman presented the Board with its Actuarial Report for June 30, 2009 containing the recommended contribution rates for the fiscal year from July 01, 2010 to June 30, 2011.

Member contribution rate	**15.34% (increase from 11.16%)**
City Contribution rate	**57.77% (increase from 52.36)**

At that time the unfunded liability was calculated at $169,483,343 using the actuarial value; $204,310,676 using the market value.

By November, 2009 the Fund increased to $130,491,863, a net increase of $10,300,543 from the previous month. A (fiscal) year end audit by Larry Brown found the Fund had lost $15,714,955 from the previous year. Employer contributions totaled $23,979,519 including settlement money that had been put into the Fund up to that date. Benefit payments totaled $15,076,882 for the fiscal year which was consistent with the previous year; refunds were up $578,908 from the previous year. The audit listed 486 retirees in the Fund, an increase of 16 and 481 active members of the Fund, a decrease of 24.

The Segal investment report for the third quarter found a $11.5 million increase in investment earnings for the quarter and a contribution increase of $4 million. Because of the added influx of funds from outside sources, it was not necessary to withdraw investment money to cover cash flow and the full investment resources were available to take advantage of market upswings. Reina advised that the Fund was slowly adding back to equities through Pictet, our international market manager, and State Street Global and equities were now basically at target allocations. Reina also reported that for the first nine

months of the calendar year, the fund was up by 15.5%; 11.49% for the first quarter of the fiscal year. The primary drivers were International Equities, Galliard and International Fixed Income. Reina noted that from 1995 to 2008 emerging countries went from 39% of global GDP to 48% of global GDP. China's share alone has gone from 5.7% to 11.4% in a 13 year period. The Board decided to put $7 million additional funds into Galliard.

The Board is continuing to evaluate alternative asset markets. The Fund has a cap of 15% on alternative investments which includes the 7.5% currently invested in real estate with PRISA. Since the Fund is in the process of withdrawing funds from PRISA, that money will become available at some point. Reina has recommended that if additional investments are added, the Board bring down the public equity allocation which is the more aggressive part of the portfolio and move 10-15% to fixed income as a way of cushioning risk. He is also suggesting that the Fund invest in either infrastructure or private equity which are alternative asset classes that would have the potential for greater returns without the problems associated with hedge funds. Because these asset classes do carry greater risk, however, than the equities in which we are currently invested, the Board is moving slowly and carefully on this decision.

The latest Fund figures available, as of November 2009, show the fund at $131,819,983, an increase of $19,445,488 over June 2009. Of that, $14,364,084 was a net increase in investment income. All of the investment managers have shown significant increases with the exception of Prudential Financial (PRISA) and the Wilshire 5000 SL Fund which is in the process of transfer.

Retirements and Terminations:

Retirements – Police	**8**
Retirements – Fire	**12**
Terminations – Police	**6**
Terminations-Fire	**1**

Terminations refers to employees that are not eligible to receive a benefit payment at the time they separate service with the City. Three of the seven terminations have relinquished all rights to a benefit payment. The remaining four are vested and did not relinquish their rights to payment.

II. DISABILITY

There was only one new disability claim filed this calendar year; two were resolved and two remain pending in the court appeals process. The primary focus was on disability process and policy. A draft ordinance encompassing policy changes for disability was pending Board approval when the Task Force was initiated. It was decided to hold the draft ordinance to allow the Task Force to make any recommendations regarding disability it felt were appropriate before presenting a new ordinance to Council. During the pendency of the Task Force, Sheila Maerz, who had headed the subcommittee developing the changes in disability policy, disqualified herself from participation in the Board, as did Dan Wichmer, the Board's attorney who was also involved in the process. Although Wichmer returned to the Board following a determination by independent legal counsel that there was no conflict of interest, the disability ordinance draft remains pending. One of the critical changes likely to be included in the draft ordinance is a change of definition for "disability" to reflect federal guidelines.

An issue that has been resolved is the legal power of the City/Board to require income verification from employees receiving disability. Because of a pending lawsuit, the Board had been unable to proceed with any income verification that was necessary for an adjustment to benefits for persons receiving outside income that exceeded Plan limits [disability payment plus the top step of the payment schedule the individual was on at the time of retirement] . As soon as the lawsuit resolved, the Board authorized Mary Mannix Decker to proceed with the income verification process. As of December 31, 2009 that process has been completed and names of non-complying recipients have been referred to the Law Department for further action. There has been some resistance from recipients who are reluctant to reveal spousal

income information. However, the Board was advised that obtaining the spouse's W-2 form was the only way to effectively verify outside income sources in some cases.

In addition to income verification, the Board is in the process of requiring a periodic review of disability benefit recipients under the age of 50 to determine if the disability continues. There are currently 31 such members. The Board had decided to require medical reviews in all these cases this year for a base line and then to require re-examination where appropriate every three years. In January, 2009, the Board contracted with Health Systems International to provide a nurse practitioner. This contract employee of the Board is used to review incoming disability applications, contact relevant physicians to arrange medical examinations and help the Board in its disability review process. Part of those responsibilities included arranging for the re-examinations. In November, the Board was notified that the nurse practitioner who has been filling this role was laid off by HSI. At present, that position remains unfilled and the re-examination process has been delayed.

III. PERSONNEL

This has been a tumultuous year for the Board in terms of personnel. The Board began the year with an interim secretary; by mid-year, Nikki White became the permanent Board Secretary. As noted above, the contract nurse practitioner position remains unfilled since November. Of even greater significance, however, was the voluntary withdrawal in May of Sheila Maerz, the city Personnel Director, Mary Mannix Decker, the City Finance Director, Dan Wichmer, the City Attorney, and Evelyn Honea, Assistant City Manager, who had been acting as director of the Board. The withdrawal came in response to suggestions of a potential conflict of interest of these members. Kenneth Homan of the Springfield Trust Company, a member of the Board, was selected to serve as chairman. After consultation with independent legal counsel, the Board requested the return of Dan Wichmer and Mary Mannix Decker.

In December Chris Thompson of the Fire Department and Brady Stark of the Police Department were elected to serve on the Board. Mr. Thompson will replace Chief David Hall, a long time member of the Board, and Mr. Stark will replace Jim McCulloch.

IV CONCLUSIONS

(The following are opinions and impressions of the Council Liaison, and have not necessarily been endorsed by the Board as an official position.)

The Board has welcomed the opportunity to provide input to City Council as it considers important changes in the Board structure. The Board has been concerned about the need to clarify the exact role of the Board and the ability to consult independent legal counsel has been a step in the right direction. It is hoped that Council will take further steps to increase regular, direct communication with the Board. One of the measures the Board approved, but unfortunately was not implemented, was for a quarterly report to Council by the Finance Director on the status of the Fund immediately following the quarterly report to the Board by Segal. Such a report could be given in a five minute segment as part of the Tuesday luncheons.

Above all, the Board would emphasize to Council the need to maintain funding of the Plan. The Board is greatly relieved that the public has understood the necessity for a sales tax to assist in funding for the next five years. However, the Plan, whether open or closed, remains a long term commitment for the City and must be properly funded for the remainder of its life. Protecting the future of the employees and their beneficiaries who remain dependent on the Plan is critical and will require vigilance and good faith on the part of all concerned. It also requires an independent, qualified and responsible Board.

Respectfully submitted,

Cynthia Rushefsky, City Council/Pension Board Liaison

January 19, 2010